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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room TWB-204
445 12th Street, SW
Washington, DC 20554

Re: CS Docket No. 99-251, *In the Matter of Applications for Consent to the Transfer of Control of Licenses—MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*

Dear Ms. Salas:

AT&T Corp. submitted the attached document today to Ms. To-Quyen Truong of the Commission staff in connection with this proceeding. Copies were also provided to Sunil Daluvoy and Royce Dickens of the Commission staff.

An original and two copies of this letter are submitted herewith in accordance with Section 1.1206(b) of the Commission's rules.

Sincerely yours,

David M. Levy

David M. Levy

An Attorney for AT&T Communications

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Ms. To-Quyen Truong
Associate Chief
Cable Services Bureau
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: In the Matter of Applications for Transfer of Control to AT&T Corp.
("AT&T") of Licenses and Authorizations Held by MediaOne Group,
Inc. (MediaOne") CS Docket No. 99-251

Dear Ms. Truong:

Enclosed please find the ex parte "Declaration of R. Glenn Hubbard and William H. Lehr on behalf of AT&T Communications." In their Declaration, Drs. Hubbard and Lehr quantify the estimated benefits that consumers are likely to obtain from greater competition in local telephone markets in the wake of the proposed merger.

Sincerely yours,



David M. Levy

An Attorney for AT&T Communications

cc: Sunil Daluvoy
Royce Dickens

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of:)	
)	
Applications for Consent to the)	
Transfer of Control of Licenses)	
)	
MediaOne Group, Inc.,)	
Transferor,)	CS Docket No. 99-251
)	
To)	
)	
AT&T Corp.,)	
Transferee)	

**DECLARATION OF
R. GLENN HUBBARD AND WILLIAM H. LEHR
ON BEHALF OF AT&T COMMUNICATIONS**

R. Glenn Hubbard and William H. Lehr do hereby depose and state as follows:

I. STATEMENTS OF QUALIFICATIONS

A. R. Glenn Hubbard

1. My name is R. Glenn Hubbard. My business address is 3022 Broadway, 609 Uris Hall, New York, New York 10027.

2. I hold the Russell L. Carson Professorship in Economics and Finance at Columbia University. During the 1997-1998 academic year, I was a visiting professor at the Harvard

Business School. At the National Bureau of Economic Research, I am a research associate in programs on corporate finance, public economics, industrial organization, monetary economics, and economic fluctuations. I am also a visiting scholar at the American Enterprise Institute, where I direct the Program on Tax Policy Research, and an advisor to the president of the Federal Reserve Bank of New York. Before joining the Columbia faculty as professor of economics and finance in 1988, I taught in the economics department of Northwestern University. I have also served as John M. Olin Visiting Professor at the University of Chicago, Visiting Professor and Research Fellow of the Energy and Environmental Policy Center at the John F. Kennedy School of Government, and John M. Olin Fellow at the National Bureau of Economic Research. My A.M. and Ph.D. degrees in economics are from Harvard University, and my B.A. and B.S. degrees are from the University of Central Florida, *summa cum laude*.

3. My professional work has centered on problems in public economics, industrial organization, natural resource economics, and monetary economics. I have authored more than eighty journal articles, edited a number of books, and authored a leading textbook in money and financial markets. I have served on the editorial boards of journals specializing in industrial economics. I have been an advisor or consultant to the Board of Governors of the Federal Reserve System, Congressional Budget Office, Federal Reserve Bank of New York, Internal Revenue Service, International Trade Commission, U.S. Department of Energy, and U.S. Department of the Treasury. In 1991-1993, I served as Deputy Assistant Secretary (Tax Analysis) of the U.S. Treasury Department where I was responsible for economic analysis of tax policy, the administration's revenue estimates, and health care policy issues.

4. I have previously filed or given testimony in telecommunications regulatory proceedings in Arizona, California, Colorado, Idaho, Iowa, Maine, Massachusetts, New Hampshire, new York and Vermont. I have also submitted numerous affidavits and declarations to the Federal Communications Commission and in proceedings regarding revisions of the Modification of Final Judgment in *United States v. Western Electric Co. et al.* (U.S.D.C., Civil Action No. 82-192). My curriculum vitae is attached as Attachment 1 with more biographical details and a listing of my writings.

B. William H. Lehr

5. My name is William H. Lehr. My business address is 94 Hubbard Street, Concord, MA 01742.

6. I am an associate research scholar of finance and economics at the Graduate School of Business of Columbia University, a research associate of the Columbia Institute of Tele-Information, and a research associate in the Center for Technology, Policy, and Industrial Development at the Massachusetts Institute of Technology. At MIT, I am executive director of the Internet and Telecoms Convergence Consortium. Before joining the Columbia faculty in 1991, I received my Ph.D. in economics from Stanford University. My M.B.A. (Wharton), M.S.E. (chemical engineering), B.S. (chemical engineering, *cum laude*), and B.A. (European history, *magna cum laude*) degrees are from the University of Pennsylvania. I have significant professional experience in the telecommunications industry through positions at consulting firms and at MCI.

7. I have previously filed or given testimony in telecommunications regulatory proceedings in California, Colorado, Connecticut, Georgia, New Mexico, Rhode Island, South Carolina, South Dakota, Utah, and Idaho. I have also submitted affidavits and declarations to the Federal Communications Commission and in a number of proceedings relating to the regulation of telecommunications services.

8. My research focuses on issues in telecommunications economics and policy. I have authored a number of professional articles on regulatory policy, standard setting, and network economics. My *curriculum vitae* is attached as Attachment 2.

II. SUMMARY

9. In this affidavit, we estimate the benefits to consumers that are likely to occur from greater competition in local telephone markets in the wake of the proposed merger between AT&T and MediaOne. We estimate that these benefits are likely to exceed \$600 million per year.

10. In Section III, we estimate the monopoly rents that the incumbent local exchange carriers ("ILECs") currently earn in the eight states where MediaOne currently operates. In Section IV, we provide a conservative estimate of the savings that consumers are likely to enjoy in those states from the more competitive market that is likely to evolve after AT&T uses the MediaOne cable network as a vehicle for entering local telephone markets in those states.

III. INCUMBENT LOCAL EXCHANGE CARRIERS EARN MORE THAN \$6 BILLION IN MONOPOLY RENTS ANNUALLY IN THE STATES WHERE MEDIAONE OPERATES.

11. Today, more than three years after enactment of the Telecommunications Act of 1996, local telephone service markets remain far from competitive. In their serving areas, the ILECs still control over 96% of all access lines and 99% of residential access lines (see Tables A and B, below).

12. The ILECs' monopoly power continues to allow them to earn substantial monopoly rents—earning substantially more than the economic costs of providing local telephone service. We estimate that the RBOCs, GTE, and United generate more than \$6.3 billion annually in monopoly rents from local telephone service in the eight states where MediaOne has its largest operating presence (New Hampshire, Massachusetts, Virginia, Georgia, Florida, Michigan, Minnesota and California). The after-tax net present value of this stream of excess earnings is likely to exceed \$38 billion.

13. These estimates are straightforward to derive. Monopoly profits may be estimated as the after-tax difference between revenue and forward-looking economic costs. We began with ARMIS data for 1998 on the basic area revenue, other local exchange revenue, end user revenue, switched access revenue, state access revenue, and LD message revenue generated by the Bell Companies, GTE, and United in each of the eight states¹. The individual components

¹ We have excluded GTE in Florida and Virginia because GTE's serving areas in these states do not overlap with MediaOne's.

of these revenue figures appear in Table D, below, and are summed in the "Total Revenue" column of Table C.

14. To determine revenue per line per month, we divided the revenue totals by the number of switched access lines controlled by the RBOCs, GTE, and United in the eight states. *See* Table C ("Switched Access Lines" and "Revenue per line per month" columns).

15. To estimate the forward-looking economic costs per month of providing local service on a per-line basis, we used estimates of the average statewide total element long run incremental cost of providing local telephone service as determined by Release 5.0 of the HAI Model, a sophisticated cost model that measures, on a disaggregated basis, the economic costs that an efficient operator would incur to provide local telephone services. We subtracted from the HAI Model estimates the estimated average cost of local number portability, billing and billing inquiry costs per line.² Then we multiplied the difference by 1.3 to account for network costs not included in the HAI Model estimates (*e.g.*, incremental costs associated with usage-sensitive toll services) and non-network related retail-level costs. The resulting per-line cost estimates appear in the column of Table C entitled "Economic costs per line per month."

² A description of these items appears in the current HAI Inputs Portfolio. *See* Letter from Richard Clarke, AT&T, to Magalie Roman Salas, FCC, filed Dec. 11, 1997, in Dockets 96-45 and 97-160, *In the Matter of the Federal-State Joint Board on Universal Service and Forward-Looking Mechanism for High Cost Support of Non-Rural LECs*.

16. To estimate the average monopoly rent per line per month, we subtracted economic costs per month from revenue per month. To account for state and federal taxes, we divided the difference by two (equivalent to an average effective tax rate of 50 percent). The results appear in the column of Table C entitled "Excess profit per line per month."

17. The estimated excess profits range from a low of \$8.23 per month per line (GTE–Michigan) to a high of \$17.24 per month per line (GTE–California), and on average (weighted by the number of access lines) are \$11.59 per line per month. To be conservative, we use \$10.00 as the average excess profits per line per month captured by the incumbent local providers in the eight states where MediaOne operates.

18. To compute an annual statewide value, we multiplied the \$10 per month in excess profits per line by 12, and then by the number of switched lines controlled by the incumbent local providers in the state. The results appear in the final column of Table C. As the table shows, the total monopoly rents earned by Bell Atlantic, BellSouth, SBC, Ameritech, U S WEST and GTE in the eight states are likely to exceed \$6 billion annually.

19. The present value of this stream of excess profits is in the tens of billions of dollars. For example, assuming a stream of excess earnings that holds constant in nominal terms

for ten years and then ceases, and an annual discount rate of ten percent, produces a net present value of \$38.4 billion.³

IV. ESTIMATED CONSUMER SAVINGS AFTER AT&T BEGINS PROVIDING LOCAL TELEPHONY AND OTHER SERVICES OVER MEDIAONE CABLE NETWORK

20. AT&T has also asked us to estimate the share of monopoly profits that is likely to be competed away in the same eight states after AT&T began providing local telephone services over the MediaOne network. We believe that a conservative estimate of the potential savings for consumers from the increased competition exceeds \$600 million per year, or \$3.7 billion in net present value. This assumes that the merger and AT&T's enhanced ability to introduce effective competition in the ILECs' serving areas cause only 10 percent of the excess profits to be competed away.

21. Our estimate of prospective savings of \$600 million per year is conservative for a number of reasons. First, we limit the estimate to only switched access lines in those states presently served by MediaOne. In those states, MediaOne's facilities pass approximately 27 percent of the homes.⁴ The excess profits earned by the ILECs from these homes exceed \$984

³ A ten-year earnings stream and a ten- percent discount rate yield an annuity factor of 6.14. \$6.26 billion * 6.14 = \$38.44 billion.

⁴ MediaOne has provided data indicating that its facilities pass approximately 8.2 million homes in the states that it serves. The Census Bureau reports that there are 30.1 million households in the eight states (U.S. Bureau of the Census, Households in the United States, July 1, 1996, ST-96-20R). Hence, we estimate that MediaOne passes 27 percent ($=8.2/30.1$) of the homes in the eight states.

million per year.⁵ We expect the merger substantially to increase AT&T's ability to offer effective competition statewide. Moreover, because the ILECs' tariffs are statewide, we expect that the ILECs will lower prices throughout each affected state to avoid a substantial loss of market share in MediaOne's service territory. Accordingly, the aggregate number of local access lines that are likely to benefit from substantial price reductions following AT&T's entry are likely to exceed the total number of lines in the eight states where MediaOne operates.

22. Second, while we expect effective competition to eventually drive prices down to economic cost, we have been conservative and have not assumed that the merger will immediately make local access markets competitive, or that the ILECs' monopoly profits will be eliminated overnight.

23. Third, other witnesses for AT&T and MediaOne have explained why combining AT&T and MediaOne will generate substantial economies of scale, scope and clustering. Our analysis, however, has ignored the benefits of such economies.

24. Fourth, our estimates are limited to the direct price savings enjoyed by existing local telephone service consumers, assuming that the quantity and quality of telephone service remains unchanged. In fact, increased competition and increased choice are likely to generate large non-price benefits for consumers as well. These benefits are likely to include an expanded

⁵ This assumes conservatively that there is only one access line per home (\$984 million = 8.2 million homes passed*12 months*\$10/line/month excess profits).

choice of services, improved quality, and better service options. Moreover, as competition lowers prices, the quantity of services demanded should increase, especially for services with more elastic demand (*e.g.*, toll calling and vertical services). In addition, the combined entity will be able to offer new services such as one-stop shopping or multimedia services. We have not attempted to quantify any of these indirect benefits, although they may very well be more significant over the long run than the direct benefits of the ILECs' competitive price reductions.

Table A

**Status and impact of local competition
on Bell Operating Companies**

	Status of Local Competition (12/31/98) ⁶			Impact of Competition: <i>Negligible</i>	
	Switched Access Lines (000s)	% Resale	% UNEs	Growth in Earnings (2Q99 over 2Q98)	Growth in Voice Grade Equivalent Circuits (2Q99 over 2Q98)
Ameritech	21,054	2.4%	0.7%	20.9% ⁷	14.7%
Bell Atlantic	41,429	1.5%	0.2%	10.3% ⁸	12.9%
BellSouth	24,104	2.3%	0.2%	24.4% ⁹	14.7%
SBC	36,778	2.3%	0.2%	15.7% ¹⁰	10.5%
US West	16,695	2.4%	1.6%	9.2% ¹¹	3.1% ¹²
Total	140,060	2.1%	0.2%		

⁶ See Table 3.1 and 3.3 in the *Local Competition Report: August 1999*, Common Carrier Bureau, Federal Communications Commission, August 1999. “%Resale” column shows the share of switched access lines that are resold via Total Service Resale or otherwise; “%UNEs” column shows the percent of switched access lines that are leased as unbundled network elements.

⁷ Source: “Ameritech Earnings Grow 20.9 Percent in Second Quarter,” Ameritech Investor Relations Press Release, Second Quarter 1999.

⁸ Source: “Bell Atlantic Announces Double-Digit Earnings Growth For Second Quarter 1999 Wireless, Data Growth Drives 10.3% Increase in Adjusted EPS,” Bell Atlantic Press Release, July 21, 1999.

⁹ Source: “BellSouth EPS Grows More Than 24% in 2nd Quarter,” BellSouth Press Release, July 21, 1999.

¹⁰ Source: “SBC 2Q Earnings Per Share Increase 15.7 Percent,” SBC Press Release, July 20, 1999.

¹¹ Source: “U S WEST Second Quarter Earnings Rise 9.2 Percent,” US WEST Press Release, July 23, 1999.

¹² Growth in access lines (2Q99 over 2Q98). This is less than growth in voice grade equivalent circuits because excludes growth in data lines. Source: US WEST Second Quarter 1999 balance sheet (<http://www.uswest.com>).

Table B

Local Switched Access Competition¹³

CLECs account for only 3.6% of total access lines.

	Switched Access Lines (2Q99)
ILECs	188,509,420
CLECs (incl. IXC)	6,992,957
Total	195,502,377
CLEC ÷ Total	3.6%

CLECs currently focus disproportionately on commercial customers (only 13.5% of CLEC customers are residential).

CLECs account for only 0.8% of residential access lines and for only 8.5% of business access lines.

	% of Carrier Switched Access Lines that are Residential	% of Total Residential Switched Access Lines	% of Total Business Switched Access Lines	% of Total Switched Access Lines
ILECs (include RBOCs)	61.9%	99.2%	91.5%	96.4%
CLECs (include IXCs)	13.5%	0.8%	8.5%	3.6%
Total	60.1%	100.0%	100.0%	100.0%

Table C: Excess ILEC Profits in MediaOne States

State	ILECs	Total Revenue (\$millions)	Switched Access Lines (000s) ¹⁴	Revenue (per line per month)	Economic costs (per line per month) ¹⁵	Excess Profit (per line per month) ¹⁶
MA	Bell Atlantic	\$ 2,378.3	4,485.0	\$ 44.19	\$ 17.71	\$ 13.24
NH	Bell Atlantic	\$ 437.8	781.4	\$ 46.69	\$ 24.93	\$ 10.88
FL	BellSouth	\$ 2,979.9	6,444.4	\$ 38.53	\$ 17.29	\$ 10.62
	United	\$ 994.6	2,006.8	\$ 41.30	\$ 22.37	\$ 9.46
GA	BellSouth	\$ 2,381.5	4,085.4	\$ 48.58	\$ 21.76	\$ 13.41
CA	SBC	\$ 7,609.0	17,915.6	\$ 35.39	\$ 14.99	\$ 10.20
	GTE	\$ 2,664.3	4,554.5	\$ 48.75	\$ 14.26	\$ 17.24
MN	U S WEST	\$ 1,176.6	2,291.6	\$ 42.79	\$ 21.61	\$ 10.59
VA	Bell Atlantic	\$ 1,656.3	3,600.3	\$ 38.34	\$ 19.93	\$ 9.20
MI	Ameritech	\$ 2,885.3	5,309.7	\$ 45.28	\$ 18.79	\$ 13.25
	GTE	\$ 418.5	702.5	\$ 49.64	\$ 33.18	\$ 8.23
Average excess profit per line						\$ 11.59
Total SW access lines			52,177.2			
Total Excess Profits per Year ¹⁷						\$6,261,264

Annual Excess After-tax Profits exceed \$6.26 Billion
Net Present Value of Excess Profits is \$38.44 Billion

¹⁴ Source: FCC ARMIS Operating Data Report 43-08, 1998, Table III, Access Lines in Service by Customer, Total Switched Access Lines, Column (dj).

¹⁵ Source: (HAI 5.0 estimates state-wide average economic cost - \$1.72 for billing and number portability)*1.3 to account for retail-level costs and other network-related costs not included in HAI estimates.

¹⁶ After-tax excess profit per line = [(Revenue per line per month)-(Economic Cost per line per month)]*0.5

¹⁷ This estimate assumes that the excess profit per line per month is \$10 instead of \$11.59 which is the access line weighted average excess profits actually realized by the ILECs.

Table D

**Total Revenue for Bell Operating Companies and GTE
in States where MediaOne Operates**

State	ILECs	Basic Service Revenue	Other LX Revenue	End User Revenue	Switched Access Revenue	State Access Revenue	L D Message Revenue	Total Revenue (\$millions)
MA	Bell Atlantic	\$ 1,103.2	\$ 262.0	\$ 267.2	\$ 394.1	\$ 56.7	\$ 295.1	\$ 2,378.3
NH	Bell Atlantic	\$ 183.2	\$ 35.2	\$ 46.9	\$ 93.7	\$ 16.6	\$ 62.2	\$ 437.8
FL	BellSouth	\$ 1,191.9	\$ 671.6	\$ 388.4	\$ 430.1	\$ 246.0	\$ 51.9	\$ 2,979.9
	United	\$ 342.1	\$ 164.3	\$ 109.8	\$ 162.2	\$ 197.3	\$ 18.9	\$ 994.6
GA	BellSouth	\$ 1,219.3	\$ 500.3	\$ 253.7	\$ 311.4	\$ 80.8	\$ 16.0	\$ 2,381.5
CA	SBC	\$ 3,323.0	\$ 903.7	\$ 923.2	\$ 567.9	\$ 762.7	\$ 1,128.5	\$ 7,609.0
	GTE	\$ 1,124.3	\$ 293.4	\$ 215.2	\$ 317.2	\$ 428.9	\$ 285.3	\$ 2,664.3
MN	U S WEST	\$ 590.1	\$ 170.9	\$ 126.8	\$ 121.5	\$ 129.7	\$ 37.6	\$ 1,176.6
VA	Bell Atlantic	\$ 840.0	\$ 254.2	\$ 204.1	\$ 149.1	\$ 155.3	\$ 53.6	\$ 1,656.3
MI	Ameritech	\$ 1,032.4	\$ 511.3	\$ 328.1	\$ 167.0	\$ 192.5	\$ 654.0	\$ 2,885.3
	GTE	\$ 135.2	\$ 46.3	\$ 35.0	\$ 54.3	\$ 107.4	\$ 40.3	\$ 418.5

Source: FCC ARMIS Joint Cost Report 43-03, 1998, Column (b) Total. Line (row) numbers: Basic Area Revenues--5001, Other Local Exchange--5060, End User--5081, Switched Access--5082(separate component of), State Access--5082(separate components of), and LD Message--5100.